An Analysis of Pennsylvania's Third Generation Anti-Takeover Legislation

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I. INTRODUCTION

The Pennsylvania General Assembly recently enacted the Pennsylvania Business Corporation Law of 1988, which will take effect on October 1, 1989. As part of this law, the legislature adopted strict anti-takeover provisions which, unlike other provisions of the law, became effective March 23, 1988. Essentially, these provisions offer protection to shareholders of corporations targeted by hostile takeover bidders. In adopting these provisions, Pennsylvania joined a growing number of states which have recently enacted new anti-takeover statutes in response to the United States Supreme Court decision in *CTS Corporation v. Dynamics Corporation of America*, which upheld the constitutionality of Indiana’s Control
Share Acquisition statute. Prior to *Dynamics*, no state anti-takeover legislation withstood constitutional challenge in the Supreme Court. In drafting the current crop of third generation anti-takeover statutes, some states predictably chose to adopt control share acquisition statutes modeled after the Indiana Act upheld in *Dynamics*, while several others adopted the Delaware approach of freezing certain business combinations between target corporations and hostile bidders for a specified period of time, often referred to as the "moratorium approach." Although similar in design to Delaware's newly enacted anti-takeover statute, Pennsylvania's provisions, in many respects, are much more aggressive in nature. Thus, this comment will explore the essential characteristics of Pennsylvania's anti-takeover provisions, the inherent distinctions between these provisions and the Delaware statute, and the significance of these distinctions in light of the Supreme Court's constitutional analysis in *Dynamics*.

II. HISTORICAL DEVELOPMENT OF STATE ANTI-TAKEOVER LEGISLATION

During the 1960's, cash tender offers grew in popularity as a means for achieving corporate control. This growth in popularity is often attributed to the fact that tender offers were beyond the reach of the existing disclosure requirements of the federal securities laws. Thus, target shareholders were at a distinct disadvantage on *CTS Corp. v. Dynamics Corporation of America*, 101 H. L. Rev. 96 (1987) [hereinafter Langevoort].

8. Statutes adopted after the Supreme Court decision in *Dynamics* are commonly referred to as third generation statutes. Statutes enacted prior to the Supreme Court's decision in *MITE* are identified as first generation statutes, while statutes enacted after the *MITE* decision and prior to *Dynamics* are often referred to as second generation statutes.
9. Although identified here as the Delaware approach, this approach was first adopted by the New York legislature in reaction to the *MITE* decision. See N.Y. Bus. Corp. Law § 912 (McKinney 1986). See Lipman, supra note 4, at S 18. In this article, the author includes Kansas and Michigan among those states which have adopted the Indiana approach, while Connecticut, Georgia, Pennsylvania and Virginia are included among those states which have adopted the Delaware approach. Idaho, Nebraska, South Carolina and Tennessee are identified as having adopted some combination of both approaches. Id.
12. See *Piper v. Chris-Craft Indus.*, Inc., 430 U.S. 1, 27 (1977). The Court noted that
tage compared to a potential acquiror in terms of information necessary in making a decision on the merits of a tender offer. In addition, target management was given insufficient time in which to make recommendations to its shareholders regarding a tender offer.

Consequently, in 1968, Congress adopted the Williams Act to remedy the adverse effects caused by this gap in federal securities regulation. The purpose of the Act is "to require full and fair disclosure for the benefit of stockholders while at the same time providing the offeror and management equal opportunity to fairly present their case." In furtherance of this purpose, the Act imposes a number of disclosure and procedural requirements on a bidder making a tender offer in which five percent or more of a class of stock registered under section 12 of the 1934 Act is acquired. Specifically, the Act requires a bidder to file disclosure statements with both the SEC and the target corporation. In addition to these disclosure requirements, the Act expands the rights of tendering shareholders. Initially, the Act allows tendering shareholders to withdraw their shares during the first seven days of the offer and at any time after sixty days from the commencement of the tender-offer. In addition, if more shares are tendered than the offeror seeks to purchase, the Act requires that the tendered shares be purchased from each tendering share-

“prior to the 1960's, corporate takeover attempts had typically involved either proxy solicitations, regulated under § 14 of the Securities Exchange Act or exchange offers of securities, subject to the registration requirements of the 1933 Act.” Id. Thus, while the Securities Act of 1933 and the Securities Exchange Act of 1934 required a variety of financial disclosures for initial public offerings and for the trade of securities on secondary markets, they did not regulate cash tender offers.

13. Piper, 430 U.S. at 27.
14. BNS, Inc. v. Koppers Co., Inc., 683 F. Supp. 458, 467 (D. Del. 1988). Specifically, the acquiror was privy to information about the financial condition of the corporation, the corporation's plans with respect to its business, and various other relevant facts about the corporation, while the shareholders were not provided with similar information concerning the acquiror. Id.
16. Piper, 430 U.S. at 27.
19. Id. § 78m(d)(1). The Act requires the bidder to disclose its identity, background, the source and amount of funds or other consideration to be used in purchasing the tender shares, the extent of its holdings in the target corporation, and the bidder's plans with respect to the target corporation's business or corporate structure. Id. § 78n(d)(1).
20. Id. § 78n(d)(5).
holder on a pro rata basis during the first ten days of the offer.\textsuperscript{21} Furthermore, if during the course of the offer the amount paid for the shares is increased, the Act requires that all tendering shareholders receive the same consideration, even if they tendered their shares before the price increase was announced.\textsuperscript{22}

Following the adoption of the Williams Act, a number of states enacted more stringent anti-takeover statutes in an attempt to provide greater protection to their resident corporations and investors.\textsuperscript{23} These statutes placed additional burdens on bidders beyond the requirements of the Williams Act.\textsuperscript{24} Consequently, bidders challenged the constitutionality of these statutes, and many were struck down by lower federal and state courts on commerce clause grounds, federal preemption grounds, or both.\textsuperscript{25}

In \textit{Edgar v. MITE Corporation,}\textsuperscript{26} the United States Supreme Court invalidated the Illinois Business Takeover Act, a first generation anti-takeover statute, on commerce clause grounds.\textsuperscript{27} Justice White, writing for a majority of the Court,\textsuperscript{28} held that the Illinois statute burdened interstate commerce by regulating non-domestic corporations.\textsuperscript{29} In addition, Justice White concluded that the Wil-

\begin{enumerate}
\item Id. § 78n(d)(6).
\item Id. § 78n(d)(7).
\item For a comprehensive analysis of these state statutes and their common characteristics, see Wilner & Landy, \textit{The Tender Trap: State Takeover Statutes and Their Constitutionality}, 45 Fordham L. Rev. 1 (1976).
\item See Garrett, \textit{Third-Generation Anti-Takeover Statutes in Oregon and Indiana after Dynamos: Target Corporations Control the Ship and Raiders are Foiled}, 24 Williamette L. Rev. 73, 79 (1988) [hereinafter Garrett].
\item 457 U.S. 624 (1982).
\item \textit{Id.} at 646. Justice White, writing for the majority, found that the Illinois statute indirectly burdened interstate commerce, and held that the burden imposed outweighed any legitimate state interests promoted by the statute. \textit{Id.} at 643-46.
\item The Justices, in fact, filed six separate opinions; however, Justice White's commerce clause analysis was adopted by a majority of the Justices. \textit{Id.} at 646. Justice White, writing for the majority, found that the Illinois statute indirectly burdened interstate commerce, and held that the burden imposed outweighed any legitimate state interests promoted by the statute. \textit{Id.} at 643-46.
\item 457 U.S. at 646. The Illinois statute applied to any corporation which met at least two of the following three conditions: (1) had its principal office located in Illinois; (2) was incorporated in Illinois; or (3) had at least 10% of its stated capital or paid in surplus repre-
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liams Act preempted the Illinois statute. In this regard, Justice White gave a broad preemptive effect to the Williams Act's policy of offeror-management neutrality. However, only a plurality of the Court agreed with Justice White's conclusion that the Illinois statute was preempted by the Williams Act.

Following the Supreme Court's decision in MITE, virtually all other first generation anti-takeover statutes were struck down by lower federal and state courts. As a result, state legislatures carefully reconstructed their statutes so as to avoid the constitutional defects of the Illinois statute invalidated in MITE. However, the MITE decision, with its six separate opinions and only a plurality opinion on the preemption issue, created uncertainty as to whether these second generation statutes would withstand constitutional scrutiny. The United States Supreme Court promptly quelled this uncertainty with its decision in CTS Corporation v. Dynamics Corporation of America.

III. CTS Corporation v. Dynamics Corporation of America

In Dynamics, the Supreme Court upheld the constitutional validity of the Indiana Control Share Acquisition Act, a second generation anti-takeover statute. Under the Indiana Act, any person presented within Illinois. Id. at 642. In addition, the statute applied to any corporation of which shareholders located in Illinois owned 10% of the class of stock subject to the tender offer. Id.

30. Id. at 633-40.
31. Id. Although Justice White recognized that the Williams Act does not expressly prohibit states from regulating takeovers, he concluded that by providing incumbent management with "powerful tool(s) to combat tender offers," the Illinois statute frustrated the Act's policy of neutrality between bidder and management. Id. at 635.
32. Only Chief Justice Burger and Justice Blackmun joined in this portion of Justice White's opinion.
33. See Garrett, supra note 24, at 79 (citing Mesa Petroleum Co. v. Cities Serv. Co., 715 F.2d 1425 (10th Cir. 1983) (invalidating Oklahoma statute); Martin-Marietta Corp. v. Bendix Corp., 690 F.2d 558 (6th Cir. 1982) (invalidating Michigan statute); Telvast, Inc. v. Bradshaw, 697 F.2d 576 (4th Cir. 1982) (invalidating Kentucky statute); Esmark, Inc. v. Strode, 639 S.W.2d 768 (Ky. 1982)). But see Agency Rent-A-Car, Inc. v. Connolly, 686 F.2d 1029 (1st Cir. 1982) (Massachusetts statute survived preemption challenge and no commerce clause challenge was made).
34. For an interesting discussion regarding the construction of these statutes, see Note, The Constitutionality of Second Generation Takeover Statutes, 73 Va. L. Rev. 203 (1987).
35. 107 S. Ct. 1637 (1987). The Dynamics decision has been interpreted as ratifying the ability of a state to statutorily regulate takeover attempts affecting corporations chartered in that state.
37. Prior to the Supreme Court's decision in Dynamics, Control Share Acquisition
obtaining sufficient shares of an "issuing public corporation" so that his voting interest would pass any of three threshold levels (20%, 33-1/3 % or 50%) must receive the approval of a majority of the target's remaining "disinterested" shareholders before he is able to vote the controlling block of shares. If the shares are not accorded voting rights by the shareholders, the corporation may redeem the control shares at fair market value. Conversely, if the control shares are granted voting rights, dissenting shareholders are statutorily entitled to receive the fair value of their shares.

After reviewing the Indiana Act, the Supreme Court upheld the Act's validity against both commerce clause and federal preemption challenges. Initially, the Court addressed the preemption issue by acknowledging that compliance with both the Williams Act and the Indiana Act was "entirely possible." Thus, the only preemption issue present before the Court was whether the Indiana Act stood "as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." In this regard, although the Court acknowledged that it was not bound by the plurality opinion in MITE, it nevertheless chose to apply Justice statutes similar to the Indiana Act had been struck down as unconstitutional. See Fleet Aerospace Corp. v. Holderman, 637 F. Supp. 742 (S.D. Ohio 1986), aff'd, 796 F.2d 135 (6th Cir. 1986), vacated, 107 S. Ct. 1949 (1987); APL Ltd. Partnership v. Van Dusen Air, Inc., 622 F. Supp. 1216 (D. Minn. 1985); Icahn v. Blunt, 612 F. Supp. 1400 (W.D. Mo. 1985). But see Terry v. Yamashita, 643 F. Supp. 161 (D. Haw. 1986) (Hawaii statute invalidated), rev'd, 788 F.2d 1566 (9th Cir. 1986). However, the Indiana statute was the first such statute to face constitutional examination in the United States Supreme Court.

38. An "issuing public corporation" is defined as an Indiana corporation that has: (1) 100 or more shareholders; (2) its principal place of business, principal office or substantial assets within Indiana; and (3) either more than 10% of its shares owned by Indiana residents, or 10,000 shareholders resident in Indiana. See IND. CODE ANN. § 23-1-42-4(a) (West Supp. 1987).

39. Id. § 23-1-41-1.

40. This shareholder vote is held at the next annual meeting or, if the acquiring person so requests, at a special meeting within 50 days of the request. See Id. § 23-1-42-7. Officers and directors of the target corporation are not entitled to vote at such meetings. Id. § 23-1-42-3.

41. See Langevoort, supra note 5, at 98.

42. Id. See IND. CODE ANN. § 23-1-42-10(b) (West Supp. 1987). In addition, the corporation has the right to redeem the control shares if the acquirer fails to file an acquiring person statement requesting control status. Id. § 23-1-42-10(a).

43. Id. § 23-1-42-11.


45. Id. at 1644.

46. Id. (quoting Ray v. Atlantic Richfield Co., 435 U.S. 151, 158 (1978); Hines v. Davidowitz, 312 U.S. 52, 67 (1941)).

47. Id. at 1645.
White's "broad interpretation of the Williams Act."48 In applying this analysis, the Court indicated that none of the "offending features" of the Illinois Act identified in MITE49 were present in the Indiana Act.60 Additionally, the majority concluded that the Indiana Act paralleled one of the essential purposes of the Williams Act by placing disinterested shareholders "on an equal footing with the takeover bidder."51 Consequently, the Court upheld the constitutional validity of the Indiana Act against the federal pre-emption challenge.52

In addition, the majority held that the Indiana statute withstood a challenge on commerce clause grounds.53 At the outset, the ma-

48. Id. The Court chose this approach for the sake of argument since it ultimately concluded that the Indiana Act passed constitutional muster even under the MITE plurality analysis. Id. However, by choosing this course of analysis, the Court failed to "definitively establish the preemptive effect" of the Williams Act on state regulation of corporate takeovers. See RP Acquisition Corp. v. Staley Continental, Inc., 686 F. Supp. 476, 481 (D. Del. 1988).

49. In MITE, the plurality identified three provisions of the Illinois statute which frustrated the principles of the Williams Act. See Edgar v. MITE Corp., 457 U.S. 624, 634-40 (1982). The first of these provisions provided for a 20 day precommencement period within which target management was allowed to present its position on the tender offer to its shareholders, while the bidder was denied an equivalent opportunity. The MITE plurality concluded that this provision frustrated the Williams Act's policy of offeror-management neutrality. Id. at 638-39.

The second of these provisions provided that, upon the request of incumbent management, the Secretary of State was to call a hearing with respect to any tender offer subject to the Illinois Act, with no set deadline for the completion of the hearing. The Act provided that the offer could not proceed during the pendency of such a hearing. Id. at 637. The MITE plurality concluded that this provision frustrated Congress' intent to avoid delays during a tender offer. Id. at 639.

The final provision identified in MITE provided for a review of tender offers by the Illinois Secretary of State to determine the substantive fairness of the offer. The plurality concluded that this provision frustrated Congress' intent that investors be given freedom to make their own decisions. Id.

50. Dynamics, 107 S. Ct. at 1645. The Court indicated that the Indiana Act: (1) does not require a precommencement period and gives shareholders equal access to the opinions of both bidder and target management; (2) requires that a shareholders' meeting be called within 50 days of the bidder's request; and (3) does not give a state administrative body the power to review the merits of a tender offer. Id. at 1644-47. See supra note 49.


52. Id. at 1649. The Court noted that if it were to construe the Williams Act to preempt any state statute which caused delay in the free exercise of power after a successful tender offer, it would necessarily have to invalidate state statutory provisions which permit staggered terms for directors or cumulative voting. Id. at 1647-48. In this regard, the Court indicated that "the longstanding prevalence of state regulation in this area suggests that, if Congress had intended to preempt all state laws that delay the acquisition of voting control following a tender offer, it would have said so explicitly." Id. at 1648. Thus, the Court concluded that any delay imposed by the Indiana Act was not unreasonable. Id.

53. Id.
jority noted that the statute did not discriminate against interstate commerce because it applied equally to both resident and foreign bidders. The Court further noted that the statute did not subject interstate activities to inconsistent regulations because it only applied to domestic corporations.

IV. PENNSYLVANIA ANTI-TAKEOVER PROVISIONS

As noted earlier, Pennsylvania's recently enacted anti-takeover legislation is modeled after the type of statute pioneered in New York and recently adopted by Delaware. Although the United States Supreme Court has not yet passed on the validity of this type of anti-takeover legislation, the constitutionality of the Delaware statute has been preliminarily upheld by the United States District Court for the District of Delaware in two recent decisions. Thus, these decisions may be indicative of how a court would analyze Pennsylvania's anti-takeover provisions in the face of a constitutional challenge. However, it is probable that Pennsylvania's provisions will be subject to a higher level of scrutiny due to their more restrictive nature.

Generally, Pennsylvania's anti-takeover provisions are aimed at preventing certain "business combinations" between a "regis-
A "registered corporation" and an "interested shareholder," or any "affiliate or associate of such interested shareholder of assets of the corporation or any subsidiary of the corporation:

(i) Having an aggregate market value equal to 10% or more of the aggregate market value of all the assets, determined on a consolidated basis, of such corporation;

(ii) Having an aggregate market value equal to 10% or more of the aggregate market value of all the outstanding shares of such corporation; or net income, determined on a consolidated basis, of such corporation.

(iii) Representing 10% or more of the earning power or net income, determined on a consolidated basis, of such corporation.

(3) The issuance or transfer by the corporation or any subsidiary of the corporation (in one transaction or a series of transactions) of any shares of such corporation or any subsidiary of such corporation which has an aggregate market value equal to 5% or more of the aggregate market value of all the outstanding shares of the corporation to the interested shareholder or any affiliate or associate of such interested shareholder except pursuant to the exercise of option rights to purchase shares, or pursuant to the conversion of securities having conversion rights, offered, or a dividend or distribution paid or made, pro rata to all shareholders of the corporation.

(4) The adoption of any plan or proposal for the liquidation or dissolution of the corporation proposed by, or pursuant to any agreement, arrangement or understanding (whether or not in writing) with, the interested shareholder or any affiliate or associate of such interested shareholder.

(5) A reclassification of securities (including, without limitation, any split of shares, dividend of shares, or other distribution of shares in respect of shares, or any reverse split of shares), or recapitalization of the corporation, or any merger or consolidation of the corporation with any subsidiary of the corporation, or any other transaction (whether or not with or into or otherwise involving the interested shareholder), proposed by, or pursuant to any agreement, arrangement or understanding (whether or not in writing) with, the interested shareholder or any affiliate or associate of the interested shareholder, which has the effect, directly or indirectly, of increasing the proportionate share of the outstanding shares of any class or series of voting shares or securities convertible into voting shares of the corporation or any subsidiary of the corporation which is, directly or indirectly, owned by the interested shareholder or any affiliate or associate of the interested shareholder, except as a result of immaterial changes due to fractional share adjustments.

(6) The receipt by the interested shareholder or any affiliate or associate of the interested shareholder of the benefit, directly or indirectly (except proportionately as a shareholder of such corporation), of any loans, advances, guarantees, pledges or other financial assistance or any tax credits or other tax advantages provided by or through the corporation.


62. A "registered corporation" is defined as:

(1) A domestic business corporation (incorporated in Pennsylvania):

(i) Having a class or series of shares entitled to vote generally in the election of directors of the corporation registered under the Securities Exchange Act of 1934 (15 U.S.C. § 78A et seq.); or


Id. § 2502. However, the anti-takeover provisions discussed herein pertain only to those registered corporations described in § 2502(1)(i). See generally 15 PA. CONS. STAT. ANN. § 2551 (Purdon Supp. 1989).
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filiate" or "associate" of such shareholder, from taking effect for a period of five years, unless certain requirements are satisfied. Like the Delaware statute, these provisions affect a number of significant corporate transactions, including mergers and sales of assets, and, in certain circumstances, the issuance of stock, rights, options and other benefits by a corporation. Thus, it is necessary to recognize which persons and transactions are subject to these provisions.

63. Id. § 2553(a). An "interested shareholder" is defined as:
(1) the beneficial owner, directly or indirectly, of shares entitling that person to cast at least 20% of the votes that all shareholders would be entitled to cast in an election of directors of the corporation; or
(2) an affiliate or associate of such corporation and at any time within the five-year period immediately prior to the date in question was the beneficial owner, directly or indirectly, of shares entitling that person to cast at least 20% of the votes that all shareholders would be entitled to cast in an election of directors of the corporation.

64. An "affiliate" is defined as a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, a specified person. Id. § 2552 (definition of "affiliate").

65. An "associate," when used to indicate a relationship with any person, is defined as:
(1) Any corporation or organization of which such person is an officer, director or partner or is, directly or indirectly, the beneficial owner of shares entitling that person to cast at least 10% of the votes that all shareholders would be entitled to cast in an election of directors of the corporation or organization;
(2) Any trust or other estate in which such person has a substantial beneficial interest or as to which such person serves as trustee or in a similar fiduciary capacity; and
(3) Any relative or spouse of such person, or any relative of the spouse, who has the same home as such person.


68. See supra note 61 and accompanying text.

69. The term "person(s)," as used herein, refers to a corporation as well as to an individual. Thus, the term will often be succeeded by the pronoun "it."

70. At this point, it is important to note that a corporation is entitled to exempt itself from the application of those provisions relating to business combinations by either:
(1)Including a provision in the original articles of incorporation which explicitly provides that such provisions are not applicable to the corporation; or
(2) Adopting an article amendment pursuant to both the procedures then applicable to the corporation and the affirmative vote of a majority of the voting shares (excluding the voting shares held by interested shareholders, their affiliates and associates) which expressly exempts the corporation from the application of such provisions.

15 PA. CONS. STAT. ANN. § 2551(b)(3)(ii)(A), (B) (Purdon Supp. 1989). However, an amendment to the articles is not effective until 18 months after its adoption and does not apply to any business combination of the corporation with an interested shareholder who acquired its shares on or prior to the effective date of the amendment. This prevents an interested shareholder from obtaining proxies or written consents sufficient to amend the articles to opt out immediately prior to the consummation of a business combination with the corporation. Corporations which adopted bylaw amendments within 90 days of the effective date of

...
An "interested shareholder" is defined, in general terms, as a person who is the beneficial owner of at least twenty percent\(^7\) of a registered corporation's voting stock.\(^8\) In this regard, a person beneficially "owns" stock when such person, individually or together with (or through) any of its affiliates\(^9\) or associates,\(^10\) possesses any of the following:

1. direct or indirect beneficial ownership of such stock;\(^11\)
2. the right to acquire such stock through any agreement, arrangement or understanding, or upon the exercise of conversion or exchange rights, warrants or options, but not until such shares are accepted for purchase or exchange;\(^12\)
3. the right to vote such shares pursuant to any agreement, arrangement, or understanding, unless the right to vote such shares arises solely from a revocable proxy or consent given in response to a proxy or consent solicitation made under the Exchange Act; or
4. an agreement, arrangement or understanding for the purpose of acquiring, holding, voting or disposing of such stock with any other person who beneficially owns such stock directly or through its affiliates or associates.\(^13\)

However, there are a number of circumstances in which a person may, in fact, own twenty percent or more of the voting shares of a corporation and still not be subject to the anti-takeover provisions. For instance, the provisions do not apply to any shareholder who becomes an interested shareholder inadvertently, provided that such shareholder: (1) as soon as practicable, divests itself of a sufficient amount of voting shares so that it no longer is the beneficial owner of twenty percent of the corporation's voting shares; and (2) but for the inadvertent acquisition, would not have been an interested shareholder at any time within a five-year period preceding the Act (by June 21, 1988), which explicitly provided that these provisions are not applicable, are also exempt from such provisions, if such bylaw amendment has not been subsequently rescinded by either an article amendment or a bylaw amendment approved by at least 85% of the board of directors. Id. § 2551(b)(3)(i). In addition, registered corporations described in § 2502(1)(ii) are automatically exempt from the application of such provisions. Id. § 2551(b)(1). See supra note 61.

\(^7\) Under Delaware law, the interested shareholder threshold is set at 15%. See Del. Code Ann. tit. 8, § 203(c)(5) (1988).

\(^8\) See supra note 63 and accompanying text.

\(^9\) See supra note 64 and accompanying text.

\(^10\) See supra note 65 and accompanying text.

\(^11\) In this context, beneficial ownership is not further defined.

\(^12\) It is significant to note that the mere right to acquire stock is deemed to be ownership of such stock regardless of whether the right is immediately exercisable or whether it may be exercised only after a certain time has passed.

the announcement date of any business combination between itself and the corporation. In addition, these provisions are inapplicable to any interested shareholder who was the beneficial owner of at least fifteen percent of the voting shares of the corporation on March 23, 1988, and who continues to own such shares up to the time it becomes an interested shareholder. Furthermore, in determining the percentage of voting shares beneficially owned by a shareholder, the following shares are excluded: (1) shares which the shareholder has held continuously since January 1, 1983; (2) shares held by the shareholder which were acquired solely by gift, inheritance, bequest, devise or other testamentary distribution, directly or indirectly, from a person who had acquired such shares prior to January 1, 1983; and (3) shares acquired pursuant to a stock split, stock dividend, reclassification or similar recapitalization which have been held continuously since their issuance by the shareholder, or by another person from whom the shares were acquired pursuant to a transaction described in (2) above.

As a general rule, once a person obtains the status of "interested shareholder," it may not effectuate any "business combination" between itself and the issuing (registered) corporation for a period of up to five years, unless one of three exceptions is satisfied. Initially, an interested shareholder is permitted to effectuate a business combination with a registered corporation if such business combination is approved by the board of directors of the corporation prior to the time the person becomes an interested shareholder. Similarly, a business combination will be exempt from the

79. Id. § 2551(b)(5). Note that this "grandfather" provision applies only to the stockholder and not to the stock itself. Thus, if the owner of such shares transfers them to another, the transferee may become subject to the provisions if he subsequently acquires sufficient additional shares to become an interested shareholder. Id.
80. Id. § 2553(b)(2)(i).
81. Id. § 2553(b)(2)(ii).
82. Id. § 2553(b)(2)(iii).
83. See supra note 61 and accompanying text.
84. Delaware only provides for a three year "moratorium" in which business combinations may not be effectuated between an interested shareholder and its issuing corporation. See Del. Code Ann. tit. 8, § 203(a)(1988).
85. See generally 15 PA. CONS. STAT. ANN. § 2555 (Purdon Supp. 1989). It must be emphasized that interested shareholders are not statutorily precluded from exercising various other rights of controlling stock ownership. Thus, such shareholders are not precluded from: (1) making tender offers directly to the stockholders; (2) making market purchases of additional shares; (3) electing their own board of directors; or (4) entering into a business combination with an unrelated party.
86. Id. § 2555(1).
general rule if the board approved of the person becoming an interested shareholder prior to the time he obtained such status. However, this exception is almost certain to be absent in the context of a hostile takeover. Thus, the interested shareholder will frequently be left with just two narrow exceptions to the five year “moratorium” imposed by the general rule. More importantly, it is these two exceptions which distinguish Pennsylvania’s anti-takeover provisions from the Delaware statute in terms of restraint on the bidder/interested shareholder.

The first of these two latter exceptions can only be satisfied if the interested shareholder: (1) acquires beneficial ownership of at least eighty percent of all of the corporation’s voting shares (including shares owned by management and employee stock plans) in compliance with certain “fair price” standards; (2) waits for a period of at least three months; and (3) thereafter, while still beneficially owning such shares, receives approval of the proposed business combination by a majority of the corporation’s disinterested shareholders. This exception differs from the comparable Delaware provision which provides that a business combination is not subject to the Delaware statute’s three-year moratorium if the shareholder acquires eighty-five percent or more of the corporation’s outstanding voting stock in the same transaction by which such shareholder becomes an interested shareholder.

Although, at first glance, it may appear that Pennsylvania’s eighty percent requirement is more lenient than Delaware’s eighty-five percent threshold, it must be noted that Delaware excludes from its eighty-five percent calculation shares owned by management and shares held in employee stock plans which do not provide participants the opportunity to tender shares on a confidential basis. Thus, upon further inspection, Pennsylvania’s requirement can be much more stringent. This is made abundantly more clear by the fact that an eighty percent shareholder in Pennsylvania must still get the approval of a majority of the disinter-

87. Id. This section is virtually identical to Delaware’s § 203(a)(1). See Del. Code Ann. tit. 8, § 203(a)(1)(1988).
89. Id. § 2555(2)(i). See Lipman, supra note 4, at S.19. The author points out that if former management owns more than 10% of the outstanding voting shares of the corporation, it still has the power to block a business combination with the interested shareholder for at least five years, regardless of whether or not such shareholder acquired 80% or more of the voting shares. Id.
91. Id.
ested shareholders to enable it to effectuate a business combination, while no comparable restriction is placed on an eighty-five percent shareholder in Delaware.\(^{92}\)

The final exception available to the interested shareholder is satisfied only if the business combination is approved by one hundred percent of the corporation's outstanding common shares.\(^{93}\) This exception is in sharp contrast to Delaware's comparable provision, which permits business combinations with an interested shareholder if they are approved by both the board of directors of the corporation and the holders of two-thirds of the corporation's outstanding voting stock.\(^{94}\) Although the Delaware statute requires prior board approval before the disinterested shareholders may vote, there is nothing preventing the interested shareholder from changing the composition of the board to ensure its approval. Thus, when viewed in this context, Pennsylvania's one hundred percent vote requirement is clearly more restrictive than Delaware's two-thirds requirement.

In addition to its more restrictive requirements, Pennsylvania's statute also permits disinterested shareholders to continue to block any business combination with an interested shareholder, beyond the five year freeze period, if the interested shareholder fails to comply with certain "fair price" provisions.\(^{95}\) This differs from the Delaware statute, which does not provide any means by which the three-year waiting period may be extended, and does not contain any fair price provisions during or after such three year period.\(^{96}\)

V. CONSTITUTIONAL ANALYSIS

Since it is clear that Pennsylvania's anti-takeover provisions are similar to, yet in some respects much more stringent than, Delaware's statute, a question arises as to whether such provisions would survive constitutional scrutiny under the analysis provided by the Supreme Court in *Dynamics* and adopted by the Delaware district court in *BNS, Incorporated v. Koppers Company*\(^{97}\) and *RP*
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Acquisition Corporation v. Staley Continental, Incorporated. Thus, the following is an illustration of how a district court (or even the Supreme Court) might analyze Pennsylvania’s anti-takeover provisions in the face of a constitutional challenge on both federal preemption and commerce clause grounds.

A. Preemption Analysis

The Delaware district court in Koppers based its preemption analysis on the following premise: “[E]ven statutes with substantial deterrent effects on tender offers do not circumvent Williams Act goals, so long as hostile offers which are beneficial to target shareholders have a meaningful opportunity for success.” The court went on to note that a state statute will be preempted only if it “frustrates the full purposes and objectives of Congress.” In this regard, the district court applied the following four part analysis: (1) whether the statute protects disinterested shareholders from coercion; (2) whether the statute gives either management or the offeror an advantage in communicating with the shareholders; (3) whether the statute imposes an indefinite or unreasonable delay on offers; and (4) whether the statute allows the state government to review the fairness of an offer.

Since both Pennsylvania’s and Delaware’s statutes are specifically designed to delay the acquisition of full control of a corporation for a period of years after a successful tender offer, the court’s treatment of the third part of the above analysis is of primary importance. In this regard, the court first noted that the statute does not impose any delay on the actual purchase of

99. This exercise will be based primarily on the Delaware district court’s interpretation of the Supreme Court’s analysis in Dynamics, since it applied this analysis to the type of statute adopted in Pennsylvania.
102. Id. (citing CTS Corp. v. Dynamics Corp. of Am., 107 S. Ct. 1637, 1646 (1987)).
103. See supra notes 61 and 83.
104. The court summarily disposed of the second and fourth inquiries as they were found to be either inapplicable (in the case of the fourth inquiry) or incapable of undergoing sufficient analysis due to the newness of the Delaware statute (in the case of the second inquiry). As to the first inquiry, the court concluded that the statute does offer protection to disinterested shareholders by eliminating freeze-outs or post-tender offer mergers between the offeror and the corporation. See Koppers, 683 F. Supp. at 469-70. These same conclusions are equally applicable to Pennsylvania’s provisions.
The court then turned its attention to the three year freeze period imposed by the Delaware statute and noted that the Delaware practice of staggering the terms of directors, alone, may delay shifts of control for up to two years. Thus, the district court concluded that the additional one year delay imposed by Delaware’s anti-takeover statute, by itself, “is not troublesome for preemption purposes.”

However, it is apparent from the district court’s reasoning in this regard that had the court been faced with a five year freeze statute similar to Pennsylvania’s it very possibly could have reached the opposite conclusion. This is especially true considering that the Pennsylvania statute, unlike the Delaware statute, provides a means by which the five year freeze period may be extended by a majority vote of disinterested shareholders. Thus, it is conceivable that a court, applying reasoning similar to that of the Delaware district court, may conclude that Pennsylvania’s freeze provisions frustrate the purposes and objectives of the Williams Act by imposing an indefinite or unreasonable delay on an offeror.

After concluding that Delaware’s three-year freeze period is not overly burdensome, the district court proceeded to examine the statutory exceptions to the Delaware statute. The court prefaced this examination by stating that the statute will be constitutional (for preemption purposes) “so long as it does not prevent an ap-

105. Id.

106. Id. Delaware permits a corporation to divide its board of directors into as many as three classes: the first class to be reelected after one year; the second class to be reelected after two years; and the third class to be reelected after three years. See Del. Code Ann. tit. 8, § 141(d) (1988). At each reelection, directors are to be chosen for a full term (three years if three classes are adopted), and such directors may not be removed without cause before their terms expire. Id. § 141(k). Thus, the term of each class will continue to expire in staggered fashion, ultimately causing a delay in the time a successful offeror may obtain control of the board up to a period of two years (the time it would take for an offeror to elect two thirds of the board).

Pennsylvania allows staggered terms of up to four years. See 15 Pa. Cons. Stat. Ann. § 1724(b) (Purdon Supp. 1989). Thus, an offeror in Pennsylvania may be subject to a delay of up to three years before he may obtain control of the board. The United States Supreme Court has implicitly upheld such common state practices as permitting corporations to stagger the terms of their directors. See supra note 52 and accompanying text.

107. Id.

108. Since Pennsylvania’s statute relating to staggered terms allows a potential delay of up to three years, see supra note 106, its five-year freeze period provides for an additional two year delay, which may have been viewed as “troublesome” by the Delaware district court.

109. See supra note 95 and accompanying text.
preciable number of hostile bidders from navigating the statutory exceptions." The district court then focused its examination primarily on the statutory exception pertaining to acquirors of eighty-five percent of the outstanding voting shares of the corporation. Although noting that this exception "may place a heavy burden on the offeror hoping to consummate the transaction despite the opposition of management," the court concluded that it was "not prepared to rule on the appropriate percentage of post-tender ownership required to insulate minority shareholders from coercive two-tier bids in the absence of facts refuting the state's determination" of the eighty-five percent threshold. Thus, the court had no alternative but to conclude that the eighty-five percent exception gives hostile offerors a meaningful opportunity to obtain full control despite management opposition.

Given the lack of analysis applied by the district court in this regard, it is difficult to predict how a court would analyze Pennsylvania's comparable eighty percent requirement. However, it is abundantly clear that Pennsylvania's requirement is much more restrictive than Delaware's eighty-five percent requirement, since Pennsylvania includes all outstanding shares in calculating the re-

110. BNS, Inc. v. Koppers Co., 683 F. Supp. 458, 470 (D. Del. 1988). This concern mirrors the court's underlying premise that hostile offers must have a meaningful opportunity for success. See supra note 100 and accompanying text.

111. Koppers, 683 F. Supp. at 470-71. See supra note 90 and accompanying text. The court dismissed the first exception pertaining to prior board approval by noting that such approval is necessarily absent in the context of a hostile takeover. 683 F. Supp. at 470.


113. Id. Subsequently, in RP Acquisition Corp. v. Staley Continental, 686 F. Supp. 476 (D. Del. 1988), the Delaware district court was presented with an abundance of statistical evidence designed to show that the 85% exception is illusory because (1) hostile offers have historically failed to achieve 85% ownership, and (2) generally, at least 16% of a corporation's voting shares are held by shareholders who are blindly pro-management or who are completely non-responsive to corporate communication (so-called "dead shares"). Id. at 482.

In response to the first assertion, the court noted that the statistical evidence proffered by the plaintiff referred to 85% ownership of all stock, whereas Delaware's statute excludes stock owned by management and stock held by employee stock plans. Id. at 483. Accordingly, the court determined that such statistics overstated the difficulty of obtaining 85% ownership, and thus, adopted the same wait-and-see approach as it did in Koppers. Id.

In response to the second assertion, the court noted that when the Delaware statute was adopted, the SEC Commissioner had calculated the common percentage of dead shares to be about five percent. In addition, the court discounted statistics showing that anywhere from 9.45% to 21.2% of shares are commonly owned by officers and/or directors, since the Delaware statute excludes shares owned by management and the plaintiff had not indicated how many of these officers and/or directors were, in fact, management. Id. Based on the above, the court concluded that "hostile offers retain a meaningful opportunity for success under the 85 percent exception." Id.

114. Id.
quired percentage and, in addition, requires the majority approval of the remaining disinterested shareholders. Thus, it is foreseeable that a court may find these restrictions too prohibitive in light of the basic premise that hostile offerors be afforded a meaningful opportunity for success.

Finally, the district court concluded that Delaware's third exception pertaining to board approval and the approval of two-thirds of the disinterested shareholders (including management) "might well be illusory." Given this conclusion, it is not beyond reason that Pennsylvania's comparable one hundred percent approval requirement would be susceptible to similar treatment.

**B. Commerce Clause Analysis**

The Delaware district court in *Koppers* analyzed the Delaware statute's compliance with the commerce clause by using the following three-part test: (1) are the effects of the statute discriminatory?; (2) does the statute create an impermissible risk of inconsistent regulation?; and (3) does the statute promote stable corporate relationships and protect shareholders? Analyzing Pennsylvania's provisions in view of these tests, it is clear that such provisions: (1) do not discriminate between offerors which are Pennsylvania corporations and offerors which are non-Pennsylvania corporations; (2) do not create a risk of inconsistent regulation; and (3) are designed to protect shareholders and inherently promote corporate relations by preventing many adverse effects associated with hostile takeovers. Although this undoubtedly appears to be a summary analysis, this is, in fact, the approach most likely to be applied by a court when analyzing Pennsylvania's antitakeover provisions on commerce clause grounds.

115. *See supra* note 89 and accompanying text.
117. *See supra* note 93 and accompanying text.
118. 683 F. Supp. at 472 (citing CTS Corp. v. Dynamics Corp. of Am., 107 S. Ct. 1637, 1648-52 (1987)).
119. As the United States Supreme Court stated in *Dynamics*: "[N]o principle of corporate law is more firmly established than a State's authority to regulate domestic corporations..." *Dynamics*, 107 S. Ct. at 1649.
120. *See supra* note 55 and accompanying text.
121. *See supra* note 3 and accompanying text.
122. *See, e.g.*, *Koppers*, 683 F. Supp. at 472-73; *Staley Continental*, 686 F. Supp. at 487-88. In *Koppers*, for instance, the court summarily applied the three-part test to the Delaware statute as follows: Under the first part, the court simply concluded that "(s)ection 203 does not discriminate between offeror's which are Delaware corporations and offerors which are not incorporated here." 683 F. Supp. at 472. Under the second part, the court
VI. CONCLUSION

Pennsylvania's newly enacted anti-takeover provisions are designed primarily to protect shareholders from coercion in tender offers. In this context, the provisions are consistent with the purposes and provisions of the Williams Act. However, the restrictiveness of these provisions will undoubtedly cause them to be subject to both criticism, by those who believe corporate takeovers to be beneficial to the economy, and heightened judicial scrutiny, in the realm of constitutional analysis.

Certainly, Pennsylvania's anti-takeover provisions constitute some of the most aggressive statutes to be thrown into the arena of state anti-takeover legislation. Nevertheless, it remains to be seen just how far states will be allowed to go in terms of regulating corporate takeover activity before Congress, once again, decides to step into the arena as well.

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merely stated that "(t)he fact that a vast majority of Delaware's corporations do not have their main office in Delaware or many resident shareholders does not prevent Delaware from regulating tender offers affecting these corporations and does not inevitably create a risk of inconsistent regulation." *Id.* Under the third part, the court summarily concluded that "the Delaware statute both promotes stable corporate relationships and protects shareholders." *Id.* at 473.